Considerations for Financial Advisors Regarding Corporate E&O Insurance Coverage

Recent statistics indicate that the number of claims against financial advisors brought as a result of an error, omission or negligence in the provision of their professional services remains steady year-over-year. The costs of these claims can be significant for advisors and the companies that employ them. Even if a claim is baseless, there is substantial cost involved in retaining counsel and proceeding to litigation or negotiating a settlement.

To address this potential risk, financial advisors purchase individual professional liability insurance (E&O) coverage. However, there is a common misconception that individual advisors’ insurance will also provide sufficient protection for the company that they own or that employs them. The reality is that an advisor’s individual E&O insurance will not provide full coverage for the corporation. If a financial advisor is the owner of a company that has licensed advisors operating under the company name or placing business through the company, or the company employs unlicensed employees, the advisor should obtain separate E&O insurance coverage for the company in order to fully transfer its risks. This separate corporate E&O coverage should also be in place where advisors are using a corporate name on their business cards, letterhead or using an incorporated entity for the purpose of being paid commission.

Potential liability for the company

It is not uncommon for a financial advisor who owns a small company to rely on the coverage that will be provided to the company as part of the individual E&O insurance policies of its agents. However, this coverage is typically limited to the vicarious liability of the company. A policy providing vicarious liability coverage will provide the company with coverage to the extent that it suffers a loss as a result of its legal liability with respect to a wrongful act of one of its employees or agents. It will not respond where the company faces a claim alleging that the company itself has committed a wrongful act. Therefore, there are a number of situations where the company may not be covered by a policy providing only vicarious liability coverage, including:

- A loss arising from the professional services provided by a former employee of the company who has left the company. If an advisor is no longer employed by a company, the company may not have continued vicarious liability coverage for their actions. Nonetheless, a company may be named in a lawsuit against a former employee for errors, omissions or negligence with respect to the services they provided while employed by the company. Claimants will often name a number of parties to ensure that they capture all those who may be liable. In addition, if the advisor was conducting business under the company name, a client who is unable to remember the previous advisor may name the company as a defendant from whom they can possibly recover damages. Where the company is named directly in a lawsuit, vicarious
liability coverage will not be sufficient to provide protection from a direct claim against the company for its own wrongful acts.

- A loss arising from the conduct of unlicensed administrative support staff. Many companies employ administrative staff and other employees who are unlicensed and do not have E&O insurance coverage. These employees will not likely qualify as “insureds” under the individual E&O coverage of the company’s advisors. Therefore, the company’s direct or vicarious liability with respect to any loss arising from the actions of unlicensed support staff will not be covered without a separate E&O policy for the corporation.

- A loss arising from the conduct of an advisor who failed to maintain E&O coverage, failed to comply with the Policy Terms and Conditions or is no longer licensed. Where a company does not have separate E&O insurance it would have to rely on the coverage of its employees and agents over which it has limited control. Advisors employed by the company may change their coverage, fail to pay their premiums, fail to comply with the Terms and Conditions of their Policy (ie. are late in reporting a claim), or purchase a policy which does not have a vicarious liability rider; all of which may put the company in jeopardy in the event that there is a claim. If an advisor is no longer licensed they will no longer qualify as an “insured” under the professional liability policy and the company will lose any vicarious liability coverage with respect to their actions.

- A loss arising from the business conducted through the company which falls outside of the advisor’s E&O policy coverage. Some companies allow agents to provide a “fee-for-service” business through the corporation, using the corporate name. If a claim arises against the agent as a result of these services, this “fee-for-service” business may be seen as an outside business activity which will not be covered by the advisor’s E&O insurance.

- A loss arising from the negligence or a wrongful act of the company. There are situations when a company may face a direct claim that includes allegations of negligent hiring, supervision or training. In the event that a company faces a claim for a loss arising from the company's negligence or wrongful act, an advisor’s E&O insurance will not respond to cover the costs of the company.

Regulatory considerations
In certain provinces, provincial regulators require member companies to have separate corporate E&O coverage. However, regardless of whether it is required by the jurisdiction in which the company is operating, it is a prudent business practice to obtain separate corporate E&O insurance.

Other considerations
Depending on the way that they carry on business in Canada, the owner of a company may find themselves financially liable for the company’s debts and obligations in some cases. As a sole proprietor of a company in Canada, the business owner assumes all of the liability of the company. Further, the limited liability that an owner obtains when a company is incorporated may not completely shield the personal assets of the owner where they have provided a personal guarantee when entering into a loan, lease, credit agreement or contract, or where they fail to keep their personal finances separate from those of the corporation.

Examples of claims
- In a recent 2013 case before the Manitoba Court of Appeal, a claim was brought against insurance agents for alleged negligence, negligent misrepresentation, breach of contract and breach of fiduciary duty regarding provision of a retirement plan to the Plaintiffs. The corporation that employed the insurance agents was also initially named in the action. The lawsuit against the corporation was eventually dropped, but not before legal costs were incurred. 1
• In Quebec, where a financial advisor continued to sell a product that was no longer supported by the company, the court found the company liable for damages on the basis that it failed to fulfill its duty to its clients to act diligently. The company was found liable for failure to adequately oversee its employee’s conduct and for failing to alert the client that it no longer endorsed the product being sold by the advisor.

Key take-aways

Separate E&O coverage for the company will:

• Remove the uncertainty surrounding a company’s coverage that exists when relying on coverage provided in agents’ E&O insurance
• Respond when a company is faced with a direct claim
• Respond when a company is named as a separate defendant in an action against one of its agents
• Provide coverage when a claim is brought as a result of “fee-for-service” business provided by an agent through the company
• Provide consistent coverage to the company instead of coverage which is limited and fragmented

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